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C O N F I D E N T I A L SECTION 01 OF 02 ABUJA 000657

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E.O. 12958: DECL: 03/23/2016
TAGS: EFIN PGOV EPET NI
SUBJECT: DELTA EVENTS AND NIGERIA'S CREDIT RATINGS

REF: A: 05 ABUJA 2373 B: ABUJA 321

Classified By: Ambassador John Campbell for reasons 1.4 a, b and d.

¶1. (C) Summary: The conclusion of the debt forgiveness deal in December greatly improved Nigeria's debt burden numbers and was a major factor in Nigeria's recent credit ratings. Though the ratings were not investment grade, they indicated a significant level of confidence in Nigeria's ability and willingness to repay debt owed by the Government of Nigeria (GON). It should be noted, however, that ratings mainly address those two relatively narrow issues, and are not a broader statement on Nigeria's political stability or economic prospects. The ratings agencies focused on the fact that any Nigerian government would be committed to keeping oil flowing and maintaining revenue, and most potential leaders would want to maintain international credibility by paying debt. Nonetheless, more recent militant successes in interrupting oil flows in the Niger Delta may force a reevaluation of some of the assumptions on which the ratings were based. End Summary.

¶2. (C) Two international credit ratings agencies, Fitch and Standard and Poor, for the first time provided ratings for Nigeria's sovereign debt, Fitch in January and S&P in February 2006. The S&P team and a JP Morgan team advising the GON on how to manage the credit rating process spoke to Mission Economic and Political officers in early December (ref A). After their reviews, both agencies rated Nigeria BB Minus (ref B). These ratings are not investment grade, meaning that under U.S. law institutional investors such as pension funds could not hold Nigerian government debt in their portfolios. The below-investment-grade rated debt is colloquially known as "junk", offering higher risk for potentially higher reward. Nigeria's rating puts her debt at the upper end of junk.

¶3. (C) According to the S&P rating team, the ratings reflect a narrow set of judgments based on the answers to two basic questions. What is the Nigerian government's current and future ability to service its debt? What is its current and future willingness to service government debt? Fitch's literature says the ratings "identify a range of key indicators of debt payment capacity and willingness." Reports normally are updated annually, but may be supplemented with regular reporting on issues affecting credit risk.

¶4. (C) At the time the rating agencies did their review, and still today, Nigeria clearly has the ability and willingness to service its debt. The recently implemented debt forgiveness agreement not only lowered Nigeria's debt burden significantly, to a mere 4.5% of GDP from nearly 60% of GDP in 2003; with its upfront USD 12 billion payment it was a

powerful demonstration of both Nigeria's willingness and ability to pay. Oil prices appear set to remain well above the $50 per barrel mark for some time to come, and Nigeria is expanding production actively. The Finance Ministry has been managing that revenue conservatively, including depositing revenues in excess of a reference price into a special account. Foreign Reserves sit at a comfortable USD 33 billion. Cleaning up Nigeria's reputation as an irresponsible debtor has been a major policy focus. All these factors combine to make a strong case for ability and willingness to repay debt. Nevertheless, other factors precluded the agencies from assigning a higher rating. In fact, some international commentators expressed surprise that the rating was as high as that of countries like Brazil or Turkey.

¶5. The positive factors cited by Fitch in justifying its ratings were the size of oil reserves and plans to increase output; the current administration's commitment to reform; and the low level of public debt following the Paris Club deal. Negative factors cited were weak institutions, poor governance and corruption; a narrow export and revenue base; significant economic and development challenges; weak data quality and transparency; and a checkered history of debt service.

¶5. (C) Under almost any conceivable scenario of Nigeria's future, the oil will continue to flow, revenue will continue to accrue, and any government will have a clear interest in currying whatever international favor it could by meeting debt obligations.

¶6. (C) Since the ratings were released, however, there have been significant developments that may affect some of the assumptions underlying the ratings. Merrill Lynch noted the

potential impact of Delta events on Nigeria's credit ratings in a recent report, calling the BB minus ratings "prematurely high." Militants in the Delta have demonstrated for the first time their ability to interrupt a significant portion of Nigeria's oil production for a significant length of time. In discussion of civil unrest in the Delta, the Fitch report specifically noted that it was not expected to result in any material reduction in oil production. With 25% of production now halted indefinitely, Nigeria can still afford to service it debt. The threat remains serious, however, that even more production could be halted. If the problem remains ongoing, it could affect the ability to pay in the future.

¶7. (C) Given that one of the militants' demands is greater autonomy and greater control of oil revenue, it lays the foundation to at least speculate about a future in which the federal government has less control over oil revenue, in which different regions seek more autonomy or even independence, or in which local populist groups become more influential. Any of these factors raise the risk that Nigeria could become less able or less willing to service and repay national debt.

CAMPBELL